BANKRUPTCY SYSTEM AND THE IMPACTS OF CORONAVIRUS

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BANKRUPTCY SYSTEM OPTIONS PAPER

The Personal Insolvency Professionals Association (PIPA) welcomes the opportunity to provide comment on the options paper issued by the Attorney General's Department regarding the bankruptcy system and the impact of coronavirus.

ABOUT PIPA

PIPA is the peak body representing Registered Debt Agreement Administrators (RDAAs). The majority of RDAAs are members of PIPA. PIPA focuses on ensuring its members are educated, professional, ethical and informed. It promotes best practice, fairness and transparency across its membership when dealing with people struggling with unmanageable debt. It works closely with government and in conjunction with Bond University, who have created the only course specific for RDAAs in Australia.

Key Points

PIPA considers the measures outlined in the options paper as an opportunity to genuinely reform the bankruptcy system. The implementation of the majority of these measures will be a step in the right direction to modernising the system.

However, any reforms need to ensure that bankruptcy does not become the “easy way out” and that measures remain in place to protect against an abuse of the bankruptcy laws.

Our current bankruptcy system puts too much focus on penalising and stigmatising the failures. Debtors faced with an insolvency event, either consumer or business, need options to choose from which are fair, viable, flexible and different. It should also reward and recognise debtors who elect to repay their debts rather than filing for bankruptcy.

Recommendations

We urge the Government to:

- Increase the term of a Debt Agreement, Part IX *Bankruptcy Act 1966*, to 5 years thus allowing all Australians and not just homeowners, to repay their debt in a sustainable and affordable arrangement, which offers the protection of the Bankruptcy Act.
- Increase the income and debt thresholds for debt agreements to $250,000 or at least match the current asset threshold.
- Make it mandatory for any entity that provides financial advice, guidance, and information to a consumer to be licensed, regulated and a member of an external dispute resolution scheme. This should apply equally to not-for-profit and for-profit entities.
- Allow creditors, which have purchased a debt to vote on the consideration paid for the debt and not the balance owing. This will align a debt agreement with a Personal Insolvency Agreement (PIA).
- Delete Section 40 (1) ha, hb, hc from the *Bankruptcy Act 1966* (The Act). This would mean that lodging a debt agreement is not treated as an act of bankruptcy.
- Allow a debtor to elect to become bankrupt upon the rejection of the debt agreement. Debtors should be entitled to put forward a good faith best offer and if rejected should not have to resubmit the same information in order to become bankrupt

These changes will allow a greater number of Australian to access the benefits and protection of *The Act* without having to file for bankruptcy.

PROPOSAL TO REDUCE BANKRUPTCY TO ONE YEAR

Bankruptcy has always been a serious matter. Unlike company liquidation, bankruptcy allows an individual to walk away from his or her debts and liabilities and make a fresh start. It values the person above mere money. The availability of bankruptcy is an important backstop to our financial system, providing a safety net that enables businesses to take entrepreneurial risks, and consumers to spend freely.

However, bankruptcy comes at a cost, and that cost is borne by the unsecured creditors of the debtor, who have provided credit to individuals in good faith, or have found themselves owed money by those individuals. The result of the debtor's bankruptcy is that these unsecured creditors are unlikely to get any part of their debt repaid from the bankruptcy administration.

There is a general expectation that government will oversee a bankruptcy regime that is both firm and fair. It is difficult to see how the proposals contained in this Options Paper will go any way to satisfying the community that reducing the official term of bankruptcy from 3 years to 1 year is either firm or fair. Although it seems harsh to say so, the perceived stigma of bankruptcy provides strong motivation for many debtors to choose a debt agreement or an informal arrangement with their creditors. People equate bankruptcy with personal and moral failure. Many clients of RDAAs gain satisfaction from making and fulfilling a repayment arrangement with their creditors and so avoiding the stigma and shame of bankruptcy.

The Senate Legal and Constitutional Affairs Legislation Committee Report into the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 explored the issues relating to a one-year bankruptcy in detail. Although the Government was in favour of reducing the term of bankruptcy to one year, the vast majority of industry stakeholders were either opposed to or skeptical of any resulting significant benefit. We do not think that the current economic circumstances has changed this. The main reasons why a one-year term of bankruptcy will have no significant impact on business stimulus are:

- The consequences of bankruptcy are the issue and many of these will be unchanged
- Bankruptcy will be listed on the individual's credit file for at least five years and the NPII for life and this will affect the bankrupt's creditor worthiness
- Overseas travel is not prohibited by bankruptcy but merely requires the trustee's consent
- The bankrupt's business and personal assets will be taken by the Trustee
- Licensing issues are primarily a State Government responsibility.

Exclude eligibility for one-year bankruptcy in certain circumstances

The proposal to exclude eligibility for one-year bankruptcy in certain circumstances misses the point, which is that the community will still consider a single year too short. The four suggested criteria to exclude eligibility will only apply to a very small percentage of bankrupts and will do little to strengthen public confidence. It is little more than a token gesture.

The most important issue for consumer bankrupts is the period of the contribution's regime, which remains unchanged at 3 years under the Enterprise Incentives Bill. Matters that would be affected by a difference between 1, 2 and 3 years for some bankrupts are the requirements relating to after-acquired property and overseas travel.

Previous offences

In considering what offence provisions should exclude a bankrupt from one-year bankruptcy, it is important to consider the reasons why an offence was committed. Consumer bankrupts include a significant proportion of individuals who have difficulty complying with legal requirements because of mental health issues, limited education, language issues or addictions such as gambling. There is little to be gained by extending their bankruptcy.
By contrast, an example should be made of bankrupts who have intentionally delayed providing information, hidden assets or engaged in phoenix activities.

PROMOTE DEBT AGREEMENTS

Debt is a social, economic and psychological issue. There has to be a system to address unmanageable debt, which allows a debtor to enter into an affordable, viable and sustainable arrangement to repay their debt and to do so over a defined period, which is fair and reasonable. Debtors deserve options.

Debt agreements were originally embraced as a socially useful method of allowing debtors to enter into a realistic repayment arrangement with creditors. Prior to the 2019 Reforms, for over 20 years debt agreements were a valuable and successful solution for people dealing with unmanageable debt. They allowed thousands of people to repay their debt over a set timeframe and at a given amount. They offered predictability, legal protection and they had to be affordable.

Debt agreements provide a superior outcome for all stakeholders to bankruptcy. Debtors avoid the stigma of bankruptcy and achieve the satisfaction of making and fulfilling a fair repayment agreement with creditors. Creditors receive a much greater return on their debt than they would from a bankruptcy administration. The government receives a share of contributions that offsets the cost of insolvency administration, and the community is satisfied with a bankruptcy and debt management regime that is firm and fair.

Community and creditor confidence in the debt agreement system has steadily grown over the years. The standards for registration as a debt agreement administrator (DAA) are now very high. However, the requirements are still less than those that apply to bankruptcy trustees, so that the costs of administration are lower.

Improving access to the debt agreement system

One of the key initiatives of the Reforms introduced by the *Bankruptcy Amendment (Debt Agreement Reform) Act 2018X* was to improve access to the debt agreement system. It was considered that the reduction of the term for non-homeowners from a maximum of five to three years for non-homeowners would achieve this outcome. This change had unexpected consequences. Rather than "expanding the system's accessibility" debt agreement numbers declined significantly. Why? Because rates of return offered to creditors over a three-year term are often commercially unacceptable. Consequently, all stakeholders are worse off.

The Reforms also created two classes of debtors: those with a home and those without a home. These changes were discriminatory and a denial of natural justice to non-homeowners because they gift the privilege of time to repay debt to homeowners while penalising non-homeowners. This is unfair and unjust.

The 5-year term for a debt agreement for all debtors should be reinstated. At the same time, it is appropriate to raise and extend the eligibility limitations, to enable more debtors to take advantage of this option.

Extend the default term limit for debt agreements to 5 years

The imposition of a 3-year limit on debt agreements for a non-homeowner was justified on the basis that it aligned the term of a debt agreement with the term of a bankruptcy. However, this overlooked the practical reality that debt agreements require the approval of creditors.

The Australian Banking Association at that time disagreed with the three-year limit because it would either mean fewer debtors would be able to service a debt agreement over 3 years or that creditors would be less likely to accept the reduced amount offered compared to payments made over 5 years.

The Senate Committee reviewing the Bankruptcy Amendment (Debt Agreement Reform) Bill in 2018 disregarded the advice of the Australian Bankers Association. The Senate committee proceeded to recommend a reduction in the terms for non-homeowner to 3 years which is now been legislated. As a result, fewer debtors were able to put forward affordable proposals that were acceptable to creditors.

We consider the only way to ensure the viability of debt agreements is to reinstate the 5-year term. Restoring the 5-year default term limit will open up practical eligibility for DA acceptance to more debtors and creditors.

Home ownership exception

Homeowners struggling with the burden of unsecured debt are in a different situation. For them, securing a debt agreement with their unsecured creditors can make the difference between having a roof over their heads and homelessness. Extending the default term limit for them can achieve the difference between keeping their home and being forced to sell.

Homeowners who seek help from RDAAs are strongly motivated to save their homes and disappointed if they are ineligible to apply for a debt agreement. Their home is more than just a roof over the head of their family. It is an asset that gives them pride and a feeling of success.

Many homeowners have mortgages for 25 or 30 years, so adding a couple of extra years to a debt agreement is likely to be acceptable to them in the context of that long-term commitment. In our experience, both debtors and creditors would consider a default term limit for homeowners of 7 years to be fair.

Substantial and unforeseen change in circumstances

Section 185M of the Bankruptcy Act gives debtors the option of applying to extend the term of their debt agreement if they suffer a substantial and unforeseen change in circumstances.

We support the proposal of extending the term of a debt agreement thus providing debtors with the flexibility to complete their agreements. There is another option, which would eliminate the need for a variation. There could be a simple change to the 6-month arrears events 185QA and 185LC (3)(b)(ii) so that a debt agreement would terminate if there 6 months without repayments or if it went 12 months past the scheduled completion date. Additionally, 185P (1) could be changed to prevent creditors from being able to propose terminations i.e., once an agreement is in place it is in place if the debtor is in compliance with the agreement.

Increase the eligibility thresholds for debt agreements

This proposal to increase debt and income thresholds to match the asset threshold will increase eligibility to apply for a debt agreement and assist more people to avoid bankruptcy.

Debtors who have debt and/or income above the current thresholds have few viable options. They could file for bankruptcy, which may affect their job, or assets etc. They could consider proposing a Personal Insolvency Agreement, which is costly. Another option is an informal arrangement, which provides little certainty. Or they could endeavor to trade out of the debt.

Debtors whose debt and/or income level exceed the current thresholds frequently contact RDAAs. They may have more debts, larger debts and better paid jobs, but these individuals are not otherwise exceptional, experiencing the statistical main triggers of insolvency, unemployment, and divorce or business failure.

An increase in the debt and income thresholds may result in some debtors presenting with more complex financial circumstances. The majority of RDAAs are skilled and competent professional who are equipped to deal with financial complexity and are regulated by AFSA and also ASIC under the 2020 Debt Management Licensing.

MINIMISING THE CONSEQUENCES OF THE DEBT AGREEMENT SYSTEM

Reduce exclusion period for proposing debt agreements

We believe there should be no exclusion period. There is no exclusion period for bankruptcy. A debtor can go bankrupt immediately upon being discharged from bankruptcy. A debtor can file for a PIA the day after the agreement completes.

It is important to note that creditors must vote to accept a Debt Agreement. If creditors want to approve a new debt agreement immediately after a debt agreement has been completed, we believe they should be able to do so.

Some people in the community are simply unlucky and have successive misfortunes or are simply poor money managers. Neither group should be punished. The existing lengthy exclusion period means creditors are worse off if debtors have to enter bankruptcy instead of applying for a debt agreement.
Proposing a debt agreement will not be an 'act of bankruptcy'

Successive governments have encouraged and supported the use of alternatives to bankruptcy and debtors have responded positively to these alternatives, particularly the debt agreement option. Unlike most consumer bankrupts, debtors who elect to rely upon a debt agreement repay creditors a portion of their debts and creditors benefit more from a debt agreement than they do from bankruptcy. Despite this, creditors treat debtors who rely upon a debt agreement as though they were bankrupt. A reason for this is that although a debt agreement is an "*alternative to bankruptcy*" proposing a debt agreement or being party to a debt agreement is "*an act of bankruptcy*". Consequently, the credit report of a debtor who is party to a debt agreement has a notation "*act of bankruptcy*" listed on their report. Few creditors understand the difference between being a bankrupt and an "act of bankruptcy" and the debtor therefore is presumed to be a bankrupt and unfairly stigmatised.

We therefore urge the Government to amend subsection 40(1) of the Act to ensure that a debtor who elects to repay their debt through a debt agreement be differentiated and not labelled as "bankrupt". In fact, their commitment to repaying their debt should be commended and they should not be "*stigmatised*" for doing so.

TARGET UNTRUSTWORTHY ADVISORS

It is important to safeguard the integrity of the bankruptcy administration and prevent fraud.
We support the proposals for bankrupts to disclose details of advisors who have provided pre-insolvency advice to them and for registered trustees make preliminary enquiries about pre-insolvency advice a bankrupt has received and provide information about these enquiries to the Inspector-General in certain circumstances.

We also support the proposal to create a new offence targeting UA activity, where there are fault elements of intention or knowledge.

Signed

Murray Grayburn
PIPA Chairman